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Department of the Treasury
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Date: March 25, 2015

Legend:

Taxpayer =

Debtors =

HRA Plan =

Disability Plan =

Dear :

This is in reply to your letter dated October 7, 2014, and subsequent correspondence concerning whether contribution to, and payments from the HRA Plan are excludable from gross income under sections 106 and 105 of the Internal Revenue Code (the Code) and whether payments made by the Disability Plan are wages subject to Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes.

Debtors filed voluntary petitions for relief under chapter 11 of title 11 of the Bankruptcy Code. The United States Bankruptcy Court issued an order directing the United States Trustee to appoint a committee to represent the Debtors' long term disabled employees who were participants in the Debtors' long term disability plans. The Debtors had historically provided a number of benefits to disabled employees, including disability coverage and medical benefits. The Bankruptcy Court subsequently issued an order approving the settlement agreement between the Debtors and the committee. The committee received Court authority to create the Taxpayer. The Taxpayer was created to establish and administer the HRA Plan and the Disability Plan.

The committee established an LLC on behalf of the long term disabled employees. In accordance with the terms of the settlement agreement, the settlement proceeds were placed into the LLC and subsequently transferred to the Taxpayer. The Taxpayer, which is exempt under section 501(c)(9) of the Code, funds the HRA Plan and the Disability Plan from the settlement proceeds.

HRA Plan

Only eligible long term disabled former employees of the Debtors who are eligible to receive benefits under the Disability Plan may become participants and receive benefits under the HRA Plan. These include former employees of one or more of the Debtors, as well as surviving spouses and eligible dependents.

The allocation made on behalf of each eligible participant in the HRA Plan from the settlement proceeds will, in general, constitute the maximum reimbursement amount available for the participant under the HRA Plan, subject to reduction for administrative costs and fees. No benefits provided under the HRA Plan are funded directly or indirectly with any participant contributions.

A participant will be able to use the full amount allocated to his or her account under the HRA Plan (subject to reduction for costs and fees). The HRA Plan will only reimburse expenses for medical care as defined in section 213(d) of the Code, including out–of-pocket medical expenses and premiums for medical insurance. Only those medical expenses incurred by a participant, or such person's spouse, dependents and children who have not attained age 27 as of the end of the taxable year, will be reimbursed. The HRA Plan will reimburse premiums for insurance covering medical care expenses. Any unused portion in an account under the HRA Plan at the end of a calendar year will be carried forward and may be used in a subsequent year until the account is fully spent. No benefits other than reimbursements of medical expenses will be available under the HRA Plan either as cash or other nontaxable or taxable benefits. The HRA Plan will reimburse medical expenses only to the extent such expenses have not been reimbursed from any other source. Each medical expense submitted for reimbursement under the HRA Plan will be substantiated.

Following the death of a participant, unused amounts will continue to be available for any remaining beneficiaries of the participant until the account is fully spent. If any amount remains in the account following the death of the participant and eligible beneficiaries, such amount will be forfeited.

Disability Plan

The Disability Plan is effective as of a certain date and provides benefits for participants. A participant is defined in the Disability Plan as a long term disabled employee of

Debtors in active pay status who is disabled and continues to be disabled at all times for which the applicable benefit payment relates. Disabled or disability is defined under the Disability Plan as a participant's inability to perform substantial and material duties of any reasonable occupation as of the date the Disability Plan was effective. A reasonable occupation is any job that a participant is or could become qualified to do with the participant's education, training, or experience. Continued disability must be the result of the accident or sickness causing the participant's disability that existed as of the date the Disability Plan was effective and for which the participant is under the direct and continuous care of a licensed physician, other than a member of the participant's family or household. Under the terms of the Disability Plan, the participant's physician must provide updated medical information on a regular basis and document the functional restrictions and limitations caused by the participant's medical condition prohibiting a return to a reasonable occupation.

Benefits payments under the Disability Plan are distributed under different schedules based on the age of the participant immediately prior to the effective date of the Disability Plan, with payments distributed on or about and after the effective date of the Disability Plan.

Taxpayer represents that the Debtors ceased all operations six months before the effective date of the Disability Plan, which means that none of the participants performed services during the month in which the first payment was made and the six-month calendar period preceding the month of the first payment under the Disability Plan, or in the six-month calendar periods preceding the dates of other payments under the Disability Plan.

Analysis

Section 61(a)(1) of the Code and section 1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in Subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106 provides that gross income of an employee does not include employer provided coverage under an accident or health plan. Section 1.106-1 of the regulations provides that the gross income of an employee does not include contributions which the employee's employer makes to an accident or HRA Plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by the employee or the employee's spouse or dependents (as defined in section 152). The employer may contribute to an accident or health plan either by paying the premium on a policy of accident or health insurance covering one or more of the employees, or by contributing to a separate trust or fund which provides accident or health benefits directly or through insurance to one or more of the employees. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health,

section 106 applies only to the portion of the contributions allocable to accident or health benefits.

Section 105(b) states that except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts that are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by the taxpayer for the medical care (as defined in section 213(d)) of the taxpayer or the taxpayer's spouse or dependents (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B)) and any child (as defined in section 152(f)(1)) who has not attained age 27 as of the end of the taxable year. Section 1.105-2 of the regulations provides that only amounts that are paid specifically to reimburse the taxpayer for expenses incurred by the taxpayer for the prescribed medical care are excludable from gross income. Thus, section 105(b) does not apply to amounts that the taxpayer would be entitled to receive irrespective of whether or not the taxpayer incurs expenses for medical care.

In Rev. Rul. 2002-41, 2002-2 C.B. 75, an employer sponsors a health reimbursement arrangement (HRA) that is paid for solely by the employer and not through salary reduction contributions. The HRA reimburses substantiated medical care expenses (as defined in section 213(d)) of participating employees and their spouses and dependents (as defined in section 152) up to a maximum annual reimbursement amount. Unused amounts from one coverage period are carried forward to subsequent coverage periods. Participating employees have no right to receive cash or any other benefit in lieu of medical expense reimbursements. In Situation 2 of Rev. Rul. 2002-41, the maximum reimbursement amount under the HRA that is not applied to reimburse medical care expenses before an employee retires or otherwise terminates employment continues to be available after retirement or termination for any medical care expense incurred by the former employee or the former employee's spouse and dependents. The ruling concludes that coverage and reimbursements made under the HRA are excludable from the gross income of participating employees under sections 106 and 105.

Notice 2002-45, 2002-2 C.B. 93, provides that an HRA is an arrangement that: (1) is paid for solely by the employer and not pursuant to salary reduction; (2) reimburses the employee for medical care expenses (as defined in section 213(d)) incurred by the employee and the employee’s spouse and dependents (as defined in section 152); and (3) provides that any unused portion of the maximum dollar amount available during the coverage period is carried forward to subsequent periods. Notice 2002-45 also provides that benefits under an HRA must be limited to reimbursements of section 213(d) expenses and that all such expense reimbursements must be substantiated to be excludable under section 105. Notice 2002-45 further provides that medical care expense reimbursements under an HRA are excludable under section 105(b) if the reimbursements are provided to the following individuals: current and former employees

(including retired employees), their spouses and dependents (as defined in section 152 as modified by the last sentence of section 105(b)), and the spouses and dependents of deceased employees.

Federal Insurance Contribution Act (FICA) taxes are imposed on wages, which are defined in section 3121(a) as all remuneration from employment, unless specifically excepted. FICA taxes consist of Old-Age, Survivors, and Disability Insurance taxes ("Social Security taxes") and the Hospital Insurance taxes ("Medicare taxes"). Section 3301 imposes Federal Unemployment Tax Act (FUTA) tax with respect to wages. Section 3306(b) defines wages for FUTA purposes as all remuneration for employment with certain specific exceptions.

Generally, payments on account of sickness or accident disability with respect to employment made by employers and third parties to employees are wages for purposes of FICA and FUTA taxes, but there are exceptions to this general rule. The relevant exceptions here are section 3121(a)(4), relating to the FICA, and section 3306(b)(4), relating to the FUTA, which provide exceptions from the definition of wages for payments made on account of sickness or accident disability by an employer to or on behalf of an employee after the expiration of 6 calendar months following the last calendar month in which the employee worked for such employer.

Accordingly, based on the information submitted, representations made and authorities cited above, we conclude as follows:

(1) Contributions and coverage under the HRA Plan, and payments and reimbursements of medical expenses made by the HRA Plan will be excludible under sections 106 and 105(b) of the Code from the gross income of the participants, their current and surviving spouses, eligible dependents and children who have not attained age 27 as of the end of the taxable year.

(2) Disability payments made by the Disability Plan are not wages subject to FICA taxes (social security and Medicare taxes) imposed under section 3121 of the Code and FUTA taxes imposed under section 3301 of the Code.

No opinion is expressed concerning the Federal tax consequences of the HRA and Disability Plans under any other section of the Code other than those specifically stated herein.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

/S/

Harry Beker
Chief, Health and Welfare Branch
Office of Associate Chief Counsel
(Tax Exempt & Government Entities)